MOBILE TERMINATION CHARGES IN AUSTRALIA

This paper has been prepared by the Department of Communications, Information Technology and the Arts (DCITA) on behalf of the Australian Government in response to the Federal Communications Commission (FCC) notice of inquiry, concerning the effect of foreign mobile termination rates on U.S. customers.

The Australian telecommunications regulatory regime is capable of resolving instances of above cost pricing where this pricing is not in the long term interest of end users, and is non discriminatory. In practice, the Australian competition regulator, the Australian Competition and Consumer Commission (ACCC), has taken action in recent times to address concerns about mobile termination rates with a view to more closely align price with underlying costs for the service. Carries based in the United States of America (AT&T and MCI) took the opportunity to make submissions to the ACCC's open consultative process.

<u>Executive summary</u>

Mobile termination charges, the charges that mobile operators levy on each other and on fixed network operators for terminating calls on their networks, have become an increasing focus of attention in many economies and in the International Telecommunications Union.

In Australia, the ACCC has recently decided that it will continue to regulate the mobile termination service, which relates to both domestic and international calls terminated on Australian mobile networks. At the same time that it made this decision, it also issued a pricing principle determination in relation to the mobile termination service. Under this determination, the ACCC specified that the price of the mobile termination service should follow an adjustment path such that there is a closer association of the price and underlying cost of the service.[1] In addition to this, the ACCC determination also included price related terms and conditions that it believed would result from application of this pricing principle using the best information available to the ACCC at the time it made this determination. The price related terms and conditions specified an adjustment path for the price of the mobile termination service that would see its price reduce to 12 cents per minute (approximately US 9 cents per minute) by January 2007. By continuing to regulate the mobile termination service, the ACCC believes it will be able to ensure mobile operators provide access to their mobile termination service at rates that will better promote the long term interests of end-users of telecommunications services.

It should be noted, however, that the pricing principle (including the price related terms and conditions contained within it) are not binding on mobile network operators (MNOs) providing the mobile termination service. Rather, they are indicative only of the approach

[1] Where underlying cost of production refer to the total service long-run incremental cost (TSLRIC) of production of the service, inclusive of an increment to account for some contribution to common organisational-level costs. Where this increment to reflect a contribution to common organisational costs is included, this is referred to as TSLRIC+.

the ACCC would likely take if required to set a price for the mobile termination service under its regulatory functions as described below.

<u>The telecommunications access regime</u>

Part XIC of the *Trade Practices Act 1974* (TPA) sets out a telecommunications access regime. The ACCC, as the independent competition regulator, may determine that particular carriage services and related services are declared services. Once a service is declared, carriers and carriage service provider (CSPs) are required to comply with standard access obligations in relation to any such services that they supply. The standard access obligations facilitate the provision of access to declared services by service providers in order that service providers can provide carriage services and/or content services. In addition to its standard access obligations, a carrier, CSP or related body must not prevent or hinder access to a declared service.

Declaration must promote the 'Long Term Interests of End Users' (LTIE) including whether it will promote competition, any-to-any connectivity and efficient and economic investment in infrastructure. Where a service is declared, the terms and conditions of supply, including price, are in the first instance those that are commercially negotiated between the parties, or as set out in any voluntary access undertaking submitted by an access provider and approved by the ACCC. If negotiations fail, or there is no accepted undertaking, the ACCC may determine terms and conditions through arbitration. The arbitration process commences when one of the parties lodges an access dispute with the ACCC.

<u>Action taken by the ACCC to regulate mobile termination charges</u>

In March 2003, the ACCC announced that it would conduct a wide-ranging review of a number of issues associated with the mobile industry (the Mobile Services Review). As part of its Mobile Services Review, the ACCC considered whether it was appropriate to continue regulation of the mobile termination service, and if so, what form of regulation would be most appropriate. In June 2004, the ACCC released its Final Report on the Mobile Terminating Access Service (MTAS) – the June 2004 Final Report. The June 2004 Final Report contained two key elements. The first was a decision to declare a Domestic Digital Mobile Terminating Access Service (MTAS). This ensured that mobile termination provided on digital mobile networks (including Global System for Mobiles (GSM), Code Division Multiple Access (CDMA) and third generation (3G)) would be subject to the telecommunications access regime in Part XIC of the TPA. Therefore, the ACCC has the power to regulate the charges payable for such services.

The second key element was the making of a pricing principle determination in relation to the MTAS. Under this determination, the ACCC specified that the price of the mobile termination service should follow an adjustment path such that there is a closer association of the price and underlying cost of the service. In addition to this, the ACCC determination also included price related terms and conditions that it believed would result from application of this pricing principle using the best information available to the

ACCC at the time it made this determination. The price related terms and conditions specified an adjustment path for the price of the mobile termination service that would see its price reduce to 12 cents per minute by 1 January 2007.

The Mobile Services Review followed a number of previous regulatory actions in relation to the mobile termination service. Initially, the ACCC deemed a MTAS on GSM mobile networks to be declared at the commencement of the telecommunications access regime in Australia in 1997. In the years following this decision, a number of disputes over the terms and conditions of access to the GSM termination access service were notified to the ACCC under Part XIC of the Act. Consequently, the ACCC developed pricing principles for the GSM termination access service which it released in July 2001. Soon after the release of this pricing principle, all remaining GSM access disputes were withdrawn. Despite the fact that the ACCC was not required to apply its principles in order to resolve any of these disputes, it held the view that the issuing of pricing principles was a useful tool to resolve disputes in relation to the MTAS.

In March 2002, the ACCC made a decision to vary the GSM termination access service declaration to make it technology-neutral, resulting in the definition of the service being varied to include terminating access on the CDMA mobile network.

The Mobile Services Review fulfilled a commitment made by the ACCC in its July 2001 report on pricing principles for the GSM terminating access service to review the success of its pricing principle on this matter after an initial two-year implementation period.

<u>How the ACCC defined the market in its June 2004 Final Report</u>

The ACCC considers that market definition involves identifying the sellers and buyers that effectively constrain the price and output decisions of firms supplying the service(s) under consideration. In its process of market definition for eligible service, the ACCC defines the service under consideration and the firm(s) supplying that service. Broadly speaking, this requires identifying the access provider(s) and their supply of the eligible service. In terms of related markets, the market definition process starts with the access seekers and providers and considers the related services that they would supply using the eligible service.

According to the ACCC, markets can be delineated in terms of their product, geographic, functional and temporal boundaries.

The ACCC's view was that the relevant markets for the eligible service for the purposes of its June 2004 Final Report were the markets for the wholesale MTAS provided on each individual MNO's network. When assessing the markets for the MTAS, the ACCC examined the structural and behavioural characteristics of these markets and determined that providers of the MTAS have 'bottleneck' control over access to an essential input in the provision of fixed-to-mobile and mobile-to-mobile calls. Further, the ACCC found that MNOs are not constrained in their pricing decisions for the MTAS and have both the ability and the incentive to raise the price of the service significantly above its underlying cost of production. The ACCC considered such above-cost pricing of the MTAS would be likely to have impacts in the related retail mobile services market and the market within which fixed-to-mobile services are provided that would not be in the LTIE.

How the ACCC found that operators had market power

The ACCC believed that MNOs had control over access to termination of calls to subscribers on their network. Consequently, the ACCC did not believe that the MTASs provided on different mobile networks were substitutable for each other because calls to a consumer connected to one mobile carrier's network cannot be terminated on another carrier's network.

In the ACCC's view, all mobile operators were unlikely to be constrained in their pricing decisions for the MTAS. However, this is not to imply that the revenue streams from retail mobile and MTAS are not inter-related. The ACCC believes that these inter-relationships are an important element when assessing the extent to which declaration of a MTAS would (or would not) be likely to promote the LTIE.

How the ACCC identified appropriate prices

In its June 2004 Final Report, the ACCC found that the price of the MTAS was likely to be substantially in excess of its underlying (TSLRIC+) cost of production. In turn, the ACCC found that this was likely to be generating outcomes in the retail mobile services market and the market within which fixed-to-mobile calls are provided that are not in the LTIE. Accordingly, the ACCC determined that the price of the MTAS should follow an adjustment path such that there is a closer association of the price and underlying (TSLRIC+) cost of the service. In addition to this, the ACCC determination also specifies that the end price of this adjustment path should be set at the upper end of the range of reasonable estimates of the TSLRIC+ of providing the services that are currently available.

As indicated above, the pricing principle determination also included price related terms and conditions that it believed would result from application of this pricing principle using the best information available to the ACCC at the time it made this determination. The price related terms and conditions specified an adjustment path for the price of the mobile termination service that would see its price reduce to 12 cents per minute by 1 January 2007.

The final (or 'end') price of 12 cents per minute was based on consideration of a range of reasonable cost estimates available to the ACCC at the time it made its determination, including consideration of cost models developed in overseas jurisdictions and TSLRIC+ estimates based on regulatory accounting data provided to it by mobile operators.

What are the prices set by ACCC

In its June 2004 pricing principle determination, the ACCC set the following adjustment path for the MTAS:

Period	Price
1 July 2004 – 31 December 2004	21 cpm
1 January 2005 – 31 December 2005	18 cpm
1 January 2006 – 31 December 2006	15 cpm
1 January 2007 – 30 June 2007	12 cpm

As indicated above, however, it should be noted that the ACCC does not directly set access prices, except in arbitrations. Hence, the ACCC's pricing principles are indicative of the approach the ACCC may make if a dispute were lodged with it for arbitration. Therefore, the pricing principles for mobile termination provide a strong guide to the approach that the ACCC would likely take if it were to arbitrate on an access dispute in relation to the mobile termination access service, or if it were required to consider to accept or reject an access undertaking in relation to the MTAS. Experience in the past with this regulatory arrangement has shown that commercially negotiated outcomes are better facilitated by the existence of ACCC pricing principles.

Growth trends for mobile subscribers

From 1993 to 2003, the Australian retail mobile services industry experienced rapid growth. In its 2003-04 Telecommunications Performance Report, the Australian Communications Authority (ACA) has identified mobile services as one of the main drivers of growth in telecommunications services. Take up of mobile subscription services grew by 15.4 per cent or 2.2 million in the 2002-03 financial year. There were around 16.5 million mobile subscription services in operation in Australia at 30 June 2004 and mobile penetration (mobile phone services per head of population) in Australia was estimated at 82 per cent.

There are four mobile network operators: Telstra, Optus, Vodafone and Hutchison/Orange. In addition, there are a number of mobile resellers and mobile virtual network operators that offer retail mobile services. At present, there are six terrestrial mobile networks in Australia, three GSM, two CDMA and one W-CDMA (3G GSM), and four satellite mobile networks. However, Hutchison and Telstra have recently announced their decision to jointly own and operate Hutchison's third generation (W-CDMA) mobile network. Similarly, Optus and Vodafone have announced plans to share infrastructure needed to provide services on 3G mobile networks. It is expected they will commence providing services using this infrastructure during 2005.

Australia-US Free Trade Agreement

The Australia-United States Free Trade Agreement (the Agreement) which came into effect on 1 January 2005 includes some obligations that apply to government measures affecting trade in telecommunications services. Measures relating to mobile services are specifically excluded from the Agreement. However, a side letter to the Agreement establishes regular consultation on issues and developments in the telecommunications and IT industry. This was intended to give government and industry greater understanding of these dynamic sectors and give them the opportunity to pursue bilateral issues of particular interest. It may be appropriate to raise any further issues the US Government has in relation to MTAS as part of the first consultations under this letter.
